Supreme Court, U.S.
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IN THE OFFICE OF THE CLERK

Supreme Court of the United States

RICHARD A. QUINN and SCOTT W. TUCKER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

HILAREE A. CASADA
Counsel of Record
JULIA F. PENDERY
GODWIN GRUBER, LLP
Renaissance Tower
1201 Elm Street
Suite 1700
Dallas, Texas 75270
(214) 939-4400

Attorneys for Petitioners

188825

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

May a district court order a wrongdoer in a securities fraud case to disgorge all business proceeds, rather than just the profits received as a result of the fraudulent activity?

LIST OF PARTIES

United Energy Partners, Inc., a defendant below, is being served as a respondent.

TABLE OF CONTENTS

	Page
Question Presented	i
List of Parties	ii
Table of Contents	iii
Table of Cited Authorities	v
Table of Appendices	viii
Opinions Below	1
Jurisdiction	1
Relevant Statutes	2
Statement of the Case	2
A. Nature of the Case	2
B. Statement of Facts	3
Reasons for Granting the Petition	4
I. The Fifth Circuit's affirmance of the district court's $7.5 million disgorgement order contradicts the Fifth Circuit's own precedent and conflicts with a majority of the other Circuits that have addressed this question.	4

Contents

		Page
A.	A party is only required to disgorge its profits resulting from the fraudulent activity.	5
B.	Legitimate business expenses should offset the disgorgement amount.	7
C.	Disgorgement of all proceeds, rather than profits, is a penalty that conflicts with the goal and purpose of disgorgement.	9
D.	Prejudgment interest is inappropriate under these facts.	10
Conclusion		12

TABLE OF CITED AUTHORITIES

Page

Cases:

Commodity Futures Trading Commission v. American Metals Exch. Corp., 991 F.2d 71 (3d Cir. 1992) 5

Commodity Futures Trading Commission v. Sidoti, 178 F.3d 1132 (11th Cir. 1999) 5

Heli-Coil Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965) 6

SEC v. Bilzerian, 29 F.3d 689 (D.C. Cir. 1994) 5

SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978) 5, 6, 9

SEC v. Bocchino, 2002 U.S. Dist. LEXIS 22047 (S.D.N.Y. 2002) ... 8

SEC v. First Jersey Sec., Inc., 101 F.3d 1450 (2d Cir. 1996), *overruled in part on other grounds*, *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997) 10

SEC v. Galaxy Foods, Inc., 417 F. Supp. 1225 (E.D.N.Y. 1976) 7, 8

Cited Authorities

Page

SEC v. Great Lakes Equities Co.,
775 F. Supp. 211 (E.D. Mich. 1991),
aff'd without opinion, 12 F.3d 214
(6th Cir. 1993) 7

SEC v. Kenton Capital, Ltd.,
69 F. Supp. 2d 1 (D.D.C. 1998) 7

SEC v. Manor Nursing Centers, Inc.,
458 F.2d 1082 (2d Cir. 1972) 9

SEC v. Patel,
61 F.3d 137 (2d Cir. 1995) 5

SEC v. Robinson,
2002 U.S. Dist. LEXIS 12811 (S.D.N.Y. 2002) ... 11

SEC v. Sargent,
329 F.3d 34 (1st Cir. 2003) 10

SEC v. Thomas James Associates, Inc.,
738 F. Supp. 88 (W.D.N.Y. 1990) 7, 8

Cited Authorities

Page

Statutes:

28 U.S.C. § 1254(1) 1

28 U.S.C. § 1291 2

Securities Act of 1933, 15 U.S.C. § 77q(a) 2

Securities Exchange Act of 1934, 15 U.S.C. § 78(j)b 2

Other Authority:

BLACK'S LAW DICTIONARY 1226 (7th ed. 1999) 6

TABLE OF APPENDICES

Page

Appendix A — Opinion Of The United States Court Of Appeals For The Fifth Circuit Filed February 18, 2004 ..... 1a

Appendix B — Memorandum Opinion And Order Of The United States District Court For The Northern District Of Texas, Dallas Division Filed January 28, 2003 ..... 8a

Appendix C — Partial Summary Judgment As To Richard A. Quinn And Scott W. Tucker Of The United States District Court For The Northern District Of Texas, Dallas Division Dated June 3, 2002 And Filed June 4, 2002 ..... 18a

Appendix D — Order Of The United States Court Of Appeals For The Fifth Circuit Denying Petition For Rehearing Filed May 3, 2004 ..... 31a

Richard A. Quinn and Scott W. Tucker, Petitioners, respectfully pray that a writ of certiorari issue to review the opinion and order of the United States Court of Appeals for the Fifth Circuit entered in this case on February 18, 2004 and May 3, 2004, respectively, which affirmed the district court's June 5, 2002 partial summary judgment order and the district court's January 18, 2003 memorandum opinion and order.

OPINIONS BELOW

The district court's June 5, 2002 partial summary judgment order is unpublished and is included as Appendix C hereto. The district court's January 18, 2003 memorandum opinion and order is unpublished and can be found at *SEC v. United Energy Partners, et al.*, 3:98-CV-0218-R, 2003 U.S. Dist. LEXIS 1247, Fed. Sec. L. Rep. (CCH) P92,441 (N.D. Tex. January 18, 2003), and is included as Appendix B hereto. The opinion of the Fifth Circuit Court of Appeals is reported at *SEC v. United Energy Partners, et al.*, 88 Fed. Appx. 744, 2004 U.S. App. LEXIS 2835, Fed. Sec. L. Rep. (CCH) P92,690 (5th Cir. February 18, 2004), and is included as Appendix A hereto. The order of the Fifth Circuit denying the petition for rehearing in this case is unpublished and is included as Appendix D hereto.

JURISDICTION

The Fifth Circuit Court of Appeals' opinion, which is the judgment sought to be reviewed, was entered on February 18, 2004. The Fifth Circuit denied Petitioners' timely-filed Petition for Rehearing on May 3, 2004.

Jurisdiction in the Supreme Court is established by 28 U.S.C. § 1254(1).

RELEVANT STATUTES

Although the underlying litigation involved the alleged violation of various federal securities laws, the issues raised in this Petition do not relate to those statutes or to any constitutional provisions, treaties, ordinances, or regulations.

STATEMENT OF THE CASE

A. Nature of the Case

In 1998, the Securities and Exchange Commission ("the Commission") sought injunctive relief against United Energy Partners, Inc. ("United Energy"), Richard A. Quinn ("Quinn"), and Scott W. Tucker ("Tucker"). The Commission contended that Quinn and Tucker had violated the antifraud provisions of the following statutes by knowingly making false and misleading statements in the course of selling securities: (1) Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a); (2) Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78(j)b; and (3) Rule 10b-5. The Commission sought disgorgement, civil penalties, and a permanent injunction against Quinn and Tucker. Thereafter, the Commission filed a motion for partial summary judgment.

The district court granted partial summary judgment and later final judgment in favor of the Commission. The district court ordered Quinn and Tucker to disgorge $7.5 million jointly and severally, together with prejudgment interest and post-judgment interest. On a consolidated appeal to the Fifth Circuit, in which the court had jurisdiction based on 28 U.S.C. § 1291, the Fifth Circuit affirmed the district court's judgment. The Fifth Circuit denied a timely filed petition for rehearing. This petition followed.

B. Statement of Facts

United Energy was an oil and gas company, that since 1994, had relied on investors to fund its lease acquisition and exploration activities and had drilled and completed sixteen oil and/or gas wells in ten separate joint ventures. Quinn, chief executive officer and ninety percent shareholder of United Energy, was responsible for the activities of United Energy and directly offered and sold undivided working interests in the oil and gas wells to investors. Tucker, executive vice president and ten percent shareholder, also directly offered and sold undivided working interests in the wells. Both sold working interests in the wells to at least 285 investors, raising approximately $7.5 million in proceeds. Quinn received $445,328.08 and Tucker received $270,508.26 from their actual employment with the company.

On January 30, 1998, the Commission filed a civil action against United Energy, Quinn, and Tucker, alleging that they had violated the antifraud prohibitions of the Securities Act and the Exchange Act, and that Tucker had separately violated the broker registration provisions of the Exchange Act. In August 1998, the district court appointed a Special Master. Thereafter, Quinn and Tucker returned all of their assets to the Special Master and surrendered their interest in United Energy.

In its June 5, 2002 order, the district court granted partial summary judgment for the Commission on its claims against Quinn and Tucker, ordered them to disgorge $7.5 million jointly and severally, awarded pre-judgment interest, and enjoined Quinn and Tucker from committing future violations. The district court later imposed a $110,000 civil penalty against each party. The court entered final judgment on March 3, 2003.

Quinn and Tucker filed a notice of appeal with the Fifth Circuit challenging the partial summary judgment and later appealed the final judgment. Those appeals were consolidated, and the Fifth Circuit affirmed the district court's orders.

REASONS FOR GRANTING THE PETITION

I. The Fifth Circuit's affirmance of the district court's $7.5 million disgorgement order contradicts the Fifth Circuit's own precedent and conflicts with a majority of the other Circuits that have addressed this question.

The district court ordered the Petitioners to disgorge $7.5 million, which corresponded to the amount the Commission contended United Energy had raised from investors between June 1995 and January 1998. In affirming that decision, the Fifth Circuit held that $7.5 million was "a reasonable estimate of the profits received by fraud." This amount, however, represents the entirety of the *proceeds* obtained by United Energy, not the *profits* Petitioners received from their involvement with United Energy. The district court's own findings show that Quinn received no more than $445,328 and Tucker no more than $279,508 from their employment with United Energy, in addition to already surrendered overrides on United Energy-sponsored wells and the $81,000 United Energy spent in 1996 for Quinn's personal benefit. Those were the only "profits" Petitioners could have possibly obtained, and, therefore, the disgorgement order entered by the district court should not have exceeded these amounts. Moreover, Petitioners had previously surrendered all gains, ill-gotten or otherwise, that they had obtained from United Energy's activities to the Special Master. As such, the entire disgorgement award amounts to an improper penalty.

A. A party is only required to disgorge its profits resulting from the fraudulent activity.

Although the decision to order disgorgement is equitable in nature, the method of calculation is not. The law is settled that a party is only required to disgorge its *profits* resulting from a fraud. *See Commodity Futures Trading Comm'n v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999) (noting that a district court may not disgorge profits obtained without the aid of any wrongdoing)[1]; *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (stating that "disgorgement need only be a reasonable approximation of the profits causally connected to the violation"); *SEC v. Bilzerian*, 29 F.3d 689 ,697 (D.C. Cir. 1994) (upholding the district court's order reasonably approximating illicit profits); *Commodity Futures Trading Comm'n v. Am. Metals Exch. Corp.*, 991 F.2d 71, 77 n.10 (3d Cir. 1992) (holding that a trial court abused its discretion by not holding a hearing to determine the amount of illegal profits); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (holding that the district court had the equitable power to order a party to disgorge only those amounts with interest by which the party profited from his wrongdoing).

In *Blatt*, the Fifth Circuit unequivocally stated that disgorgement is not punitive. *Blatt*, 583 F.2d at 1335. The court further held that a court's disgorgement power "extends only to the amount with interest by which the

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1. Cases involving the Commodity Exchange Act have followed the rationale supporting disgorgement in actions under the securities laws—that allowing a violator to retain the profits from his violation would frustrate the purposes of the regulatory scheme. *Id.* at n.9. Thus, the law applied in cases involving the Commodity Futures Trading Commission also applies to cases where the Securities Exchange Commission is a party.

defendant profited from his wrongdoing." *Id.* In that case, the district court properly ordered the defendant to disgorge his $315,000 in profits. *Id.* at 1335-36. The term "profit," being undefined by the Securities Exchange Act, must be assumed to have its ordinary or usual meaning: the excess of revenues over expenditures in a business transaction. *Heli-Coil Corp. v. Webster*, 352 F.2d 156, 168 (3d Cir. 1965); BLACK'S LAW DICTIONARY 1226 (7th ed. 1999).

Here, the Fifth Circuit seemingly disregarded this well-established precedent and affirmed a disgorgement award that far exceeded the amount the evidence showed as Petitioners' profits from the alleged wrongdoing. The Fifth Circuit justified that error by holding that the $7.5 million "is a reasonable estimate of the profits received by fraud." The summary judgment evidence showed, and the district court found, however, that the profits realized by Petitioners did not exceed $796,000. Thus, the district court's own findings show that the $7.5 million is not even close to a "reasonable approximation" of the purported ill-gotten gains received by Quinn and Tucker. The district court simply disregarded its own findings as to the amounts Quinn and Tucker actually received as profits from their activities with United Energy and instead improperly used the total (and disputed) proceeds received from United Energy's fund-raising activities. This is a clear misapplication of not only Fifth Circuit precedent, but also well-established precedent from a majority of the circuits that have addressed this issue. A writ of certiorari is necessary in this case to correct the conflict created by these decisions and to ensure that Petitioners are not improperly forced to endure a punitive disgorgement award.

B. Legitimate business expenses should offset the disgorgement amount.

The Fifth Circuit also improperly refused to offset the disgorgement amount with legitimate business expenses. As noted *supra*, a disgorgement award should not exceed the profits actually gained by the wrongdoer. Here, the district court's disgorgement order far exceeds the profits realized by Petitioners and fails to take into account the monies used by United Energy for legitimate business expenses.

Disgorgement awards may be off-set by legitimate business expenses in furtherance of the participants' investment objectives. *SEC v. Thomas James Assocs., Inc.*, 738 F. Supp. 88, 92-93 (W.D.N.Y. 1990); *SEC v. Galaxy Foods, Inc.*, 417 F. Supp. 1225, 1249-50 (E.D.N.Y. 1976). The Fifth Circuit's statement that "the overwhelming weight of authority holds that securities law violators may not offset their disgorgement liability with business expenses" overstates the state of the law and relies on cases that are distinguishable from the case at bar. Although the district courts in the District of Columbia and the Eastern District of Michigan have held that legitimate business expenses do not have to be used to off-set a disgorgement amount, those cases involve situations where the business expenses were expended to further the fraud. *See SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 16 (D.D.C. 1998) (stating that a party who obtains funds fraudulently may not escape disgorgement by asserting that expenses associated with the fraud were legitimate); *SEC v. Great Lakes Equities Co.*, 775 F. Supp. 211, 214 (E.D. Mich. 1991), *aff'd without opinion*, 12 F.3d 214 (6th Cir. 1993) (holding that deductions for overhead were not warranted since the manner in which the defendants chose to spend their misappropriation was irrelevant to their

objection to disgorgement). Where, as here, the business expenses were used to further legitimate business goals, rather than the fraud, those expenses may be applied to offset the disgorgement amount. *See SEC v. Bocchino*, 2002 U.S. Dist. LEXIS 22047, *7 (S.D.N.Y. 2002) (holding that a court may deduct expenses incurred while garnering the illegal profits, including correspondence and related expenses and transaction costs); *see also SEC v. Thomas James Assocs., Inc.*, 738 F. Supp. 88, 92-93 (W.D.N.Y. 1990); *SEC v. Galaxy Foods, Inc.*, 417 F. Supp. 1225, 1249-50 (E.D.N.Y. 1976).

Here, the district court found that at least half of the aggregate subscription proceeds were devoted to drilling expenses. (Finding No. 38). Those expenditures were earmarked and used for the very purposes promised to the investors—drilling and completing oil and gas wells. Those funds, therefore, furthered the participants' investment objectives and should offset the disgorgement amount. The purpose of disgorgement is to force a defendant to give up the amount by which he was unjustly enriched and deprive him of his ill-gotten gain. Denying offset for legitimate business expenses frustrates this purpose and unfairly penalizes the defendant. The amount of business expenses used in the daily operations of a business are not amounts or profits by which a defendant would be unjustly enriched. These types of expenses would occur regardless of whether a party was committing some type of fraud.

The disgorgement order overlooks the purpose of disgorgement and results in a punitive award against Petitioners that, when combined with the $110,000 civil penalty assessed against each Petitioner, results in an excessive and improper penalty. It also denies Petitioners

offsets that were earned without any fraudulent activity. Such an outcome cannot stand, especially in situations, such as this, where Petitioners have surrendered all of their assets and have then been ordered to disgorge proceeds above any profits earned.

C. Disgorgement of all proceeds, rather than profits, is a penalty that conflicts with the goal and purpose of disgorgement.

The primary purpose of disgorgement is to "deprive the wrongdoer of his ill-gotten gain." *Blatt*, 583 F.2d at 1335. Requiring payment of any further sum, therefore, constitutes an improper penalty assessment. *Id.*; *see also SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972). The disgorgement order in this case is an improper penalty.

Here, the district court found that Quinn received $445,328 in addition to the previously surrendered overrides and payment of personal expenses from his employment with United Energy, and that Tucker received $270,508 in addition to the previously surrendered overrides and payment of personal trip expenses. Yet, instead of ordering disgorgement of those amounts, the district court ordered disgorgement of all the money raised by United Energy from the investors during Petitioners' employment. This award is, thus, nothing more than a penalty that thwarts the purpose of disgorgement.

Moreover, Petitioners have already surrendered all of their assets to the Special Master. By surrendering those assets, Petitioners have given up all gains obtained from United Energy's activities. The $7.5 million, therefore, amounts to additional disgorgement above the amount of actual gains and requires Petitioners to pay monies obtained

lawfully following their employment at United Energy. That amounts to a punitive award that does not comport with the purposes of disgorgement and of the Act.

D. Prejudgment interest is inappropriate under these facts.

The district court's errors in determining a disgorgement amount make its award of prejudgment interest improper. In deciding whether such an award is appropriate and what amounts should be assessed, a district court should consider "the need to fully compensate the wronged party for actual damages suffered; considerations of fairness and the relative equities of the award; the remedial purposes of the statute involved; and/or such other general principles as are deemed relevant by the court." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1477 (2d Cir. 1996), *overruled in part on other grounds*, *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997). The theory underpinning an award of prejudgment interest is that a defendant should be prevented from "obtaining the benefit of an interest free loan procured as a result of illegal activity." *SEC v. Sargent*, 329 F.3d 34, 41 (1st Cir. 2003) (internal citation omitted).

Quinn and Tucker did not receive an "interest free loan" of the disgorgement amounts because they gave up everything of value they owned to the Special Master. Their self-imposed penury demonstrates that if they had been unjustly enriched, they were, after their disgorgement, no longer so situated.

Further, the Commission relied on factors set out in *SEC v. First Jersey Securities* as authority for the district court's assessment of prejudgment interest, but curtly dismissed the first factor, "the need to fully compensate the wronged party

for actual damages suffered," as irrelevant. Because the Commission did not establish that it is a victim, it cannot show that there is any need to fully compensate the Commission. This is, however, exactly what the district court did in response to the Commissioner's Motion for Partial Summary Judgment; it set a disgorgement amount equal to the entire amount of money that the Commission claimed investors paid over to United Energy. Indeed, the district court's partial summary judgment order provides no analysis of "the need to compensate the wronged party," and the district court made no finding that anyone was wronged. The district court did not apply the appropriate factors and, therefore, the order of prejudgment interest should be reversed.

Alternatively, should this court determine that the amount of disgorgement should be reduced and that an award of prejudgment interest is appropriate, the amount of prejudgment interest must be recalculated according to the reduced disgorgement amount. *See SEC v. Robinson*, 2002 U.S. Dist. LEXIS 12811, *33 (S.D.N.Y. 2002) (ordering the SEC to recalculate prejudgment interest on the revised disgorgement total).

CONCLUSION

Petitioners Richard A. Quinn and Scott W. Tucker, therefore, respectfully pray that the Court issue a writ of certiorari to review the Fifth Circuit's opinion in this case.

Respectfully submitted,

HILAREE A. CASADA
Counsel of Record
JULIA F. PENDERY
GODWIN GRUBER, LLP
Renaissance Tower
1201 Elm Street
Suite 1700
Dallas, Texas 75270
(214) 939-4400

Attorneys for Petitioners

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT FILED FEBRUARY 18, 2004

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 02-10850
c/w No. 03-10322

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

versus

UNITED ENERGY PARTNERS, INC., ET AL.,

Defendants,

RICHARD A. QUINN; SCOTT W. TUCKER,

Defendants-Appellants.

Appeal from the United States District Court
for the Northern District of Texas
(3:98-cv-218-R)

Before SMITH, BARKSDALE, and CLEMENT, Circuit Judges.

Appendix A

PER CURIAM:*

In these consolidated appeals, Richard A. Quinn and Scott W. Tucker contest the underlying summary judgment, injunction, and other aspects of the judgment entered against them, arising out of their investment solicitation and related activities with United Energy Partners, Inc. Essentially for the reasons stated **by the district court, as briefly discussed below, the judgment is AFFIRMED**.

I.

Quinn was, among other things, chief executive officer and 90 percent shareholder of United Energy, which was in the business of drilling oil and gas wells; Tucker was executive vice president and ten percent shareholder. Quinn and Tucker sold working interests in United Energy wells to at least 285 investors, raising approximately $7.5 million.

The Securities and Exchange Commission filed this action against United Energy, Quinn, and Tucker in 1998, claiming knowing false and misleading statements in selling securities, in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78b, and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q.

Quinn and Tucker were charged with misrepresenting the uses of investors' funds by failing to disclose, among other things, that half of the money raised was used for United Energy's operations (despite statements in the offering memoranda that all funds raised would be spent on drilling).

* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

Appendix A

The district court: appointed a special master to represent United Energy; granted partial summary judgment for the SEC on its claims against Quinn and Tucker but took no action on the claims against United Energy; enjoined Quinn and Tucker from further violation of the securities laws; ordered them to disgorge, jointly and severally, the $7.5 million; awarded the SEC pre-judgment interest of approximately $2 million; and imposed a $110,000 civil penalty each against Quinn and Tucker.

II.

Quinn and Tucker challenge the summary judgment, the injunction, the disgorgement order, the pre-judgment interest, and the penalty.

A.

A summary judgment is reviewed *de novo*, applying the same standard as the district court. *E.g., Daniels v. City of Arlington*, 246 F.3d 500, 502 (5th Cir.), *cert. denied*, 534 U.S. 951 (2001). Such judgment is proper if the movant demonstrates there is no material fact issue and that it is entitled to a judgment as a matter of law. FED. R. CIV. P. 56(c); *e.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986); *Crawford v. Formosa Plastics Corp.*, 234 F.3d 899, 902 (5th Cir. 2000).

The summary judgment was proper. For example, the offering memoranda represented that the total funds raised would be spent on completion of the wells and did not disclose that part of those funds would be given to United Energy or to its employees as commission. Although Quinn and Tucker dispute raising $7.5 million, they admitted doing so in their answer.

Quinn and Tucker contend the SEC was not entitled to judgment because the undisputed facts did not establish scienter, but it is obvious that the summary judgment record showed they acted with intent to defraud. For example, they were aware that the stated drilling costs were double the anticipated costs.

B.

Quinn and Tucker's being enjoined from further violations of the federal securities laws is proper if "the inferences flowing from defendant's prior illegal conduct, viewed in light of present circumstances, betoken a 'reasonable likelihood' of future transgressions". *SEC v. Zale Corp.*, 650 F.2d 718, 720 (5th Cir.), *cert. denied,* 454 U.S. 1124 (1981). Injunctive relief is reviewed for abuse of discretion. *E.g., SEC v. Blatt,* 583 F.2d 1325, 1334 (5th Cir. 1978).

There was no abuse of discretion. The district court ruled that Quinn and Tucker knowingly violated the securities laws and found that Quinn stated his intention to return to the securities business (even though Quinn asserts he would only do so if he could be "in compliance").

C.

Concerning the $7.5 million disgorgement order, Quinn and Tucker claim disgorgement should instead be based only on the much smaller amount they received through their employment with United Energy. Claiming they do not have sufficient funds to disgorge $7.5 million, Quinn and Tucker further contend that ordering them to do so is a penalty, contrary to the purpose of disgorgement. They also claim that the district court: should have

offset against the disgorgement order the amounts spent on legitimate business expenses; and should not have ordered them to disgorge funds jointly and severally, because the amount each received from their involvement with United Energy was clearly determined. The equitable decision to order disgorgement is reviewed for abuse of discretion. *E.g., SEC v. AMX, Int'l, Inc.*, 7 F.3d 71, 73 (5th Cir. 1993).

There was no abuse of discretion. The $7.5 million raised is a reasonable estimate of the profits received by fraud. What Quinn and Tucker received from their *employment* with United Energy is not determinative; likewise, their inability to pay is irrelevant. Disgorgement deprives wrongdoers of ill-gotten gains; and a person remains unjustly enriched by what was illegally received, whether he retains the proceeds of his wrongdoing. *E.g., SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C.Cir. 2000).

In addition, although some courts have offset legitimate business expenses against a disgorgement amount, *e.g., SEC v. Thomas James Associates, Inc.*, 738 F.Supp. 88, 95 (W.D.N.Y. 1990), "the overwhelming weight of authority hold [s] that securities law violators may not offset their disgorgement liability with business expenses". *SEC v. Kenton Capital, Ltd.*, 69 F.Supp.2d 1, 16 (D.D.C. 1998) (citing *SEC v. Hughes Capital Corp.*, 917 F.Supp. 1080, 1086 (D.N.J. 1996), *aff'd* 124 F.3d 449 (3d Cir.1997)). Moreover, as the SEC acknowledges, Quinn and Tucker are to receive a set-off for amounts repaid to investors or collected by the special master. Lastly, joint and several liability is appropriate in securities cases where, as here, individuals collaborate or have close relationships in engaging in illegal conduct. *E.g., SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3d Cir. 1997).

Appendix A

D.

Quinn and Tucker next challenge the pre-judgment interest on the disgorgement amount, claiming: they did not have use of the full $7.5 million and relinquished their assets to the special master; there was no wronged party to compensate through such interest; and the SEC did not settle with Quinn and Tucker despite their willingness to do so. An award of pre-judgment interest is reviewed for abuse of discretion. *E.g., SEC v. First Jersey Securities, Inc.,* 101 F.3d 1450, 1476 (2d Cir.1996), *cert. denied,* 522 U.S. 812 (1997); *Wolf v. Frank,* 477 F.2d 467, 479 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973).

There was no abuse of discretion. For example, the court, in its discretion, reduced the IRS underpayment rate of interest by half from the date when Quinn and Tucker turned over their assets to the special master; and the parties' not reaching settlement does not bear on the award.

E.

Finally, Quinn and Tucker contest the imposition of third-tier civil monetary penalties of $110,000 against each of them. Such penalties are proper if: the violation involved "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; and "such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial loss to other persons". 15 U.S.C. § 78u(d)(3)(B)(iii); 17 C.F.R. § 200.1001 (raising the maximum penalty per violation to $110,000). The district court found both requirements met. The imposition of civil penalties is reviewed for abuse of discretion. *R&W Technical Serv. Ltd. v. CFTC,* 205 F.3d 165, 177 (5th Cir. 2000).

Appendix A

Quinn and Tucker contend: no investor suffered substantial losses and any risk of loss from the failure of the wells was disclosed; they did not receive the full $7.5 million they were ordered to disgorge, therefore a civil fine amounts to a double penalty; and, under the facts of this case, the penalty serves no public interest. In the light of the district court's findings, there was no abuse of discretion.

III.

Essentially for the reasons stated by the district court, the judgment is ***AFFIRMED***.

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION FILED JANUARY 28, 2003

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

CIVIL ACTION NO. 3:98-CV-0218-R

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

UNITED ENERGY PARTNERS, INC.,
RICHARD A. QUINN, and
SCOTT W. TUCKER,

Defendants.

MEMORANDUM OPINION AND ORDER

Now before this Court is Plaintiff, the Securities and Exchange Commissions's ("SEC"), *Motion to Enter Judgment as to Richard A. Quinn and Scott W. Tucker Establishing Amount of Prejudgment Interest and Setting Civil Money Penalties and to Administratively Close Case and Memorandum in Support* (filed October 2,

2002)("Plaintiff's Motion").[1] For the reasons discussed below, Plaintiff's Motion is **GRANTED** as modified herein.

I. BACKGROUND

On June 5, 2002 this Court granted partial summary judgment against Defendants, Richard A. Quinn and Scott W. Tucker ("Quinn and Tucker").[2] Among the specific conclusions of law made by the Court, in its June 5, 2002 Opinion, were that each of Quinn and Tucker "has violated and unless enjoined is likely to continue to violate 15 U.S.C. § 77q(a)(1)-(3), 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5."[3] The Opinion found Quinn and Tucker jointly and severally liable for the violations of United Energy Partners, Inc. ("UEP") and enjoined Quinn and Tucker from

1. Plaintiff's Motion has been copiously briefed by the parties. Specifically, the additional pleadings addressed in this Opinion are: *Defendants' Response to Motion to Enter Judgment* (filed October 23, 2002) ("Defendants' Response"); *Reply Memorandum in Support of Motion to Enter Judgment as to Richard A. Quinn and Scott W. Tucker Establishing Amount of Prejudgment Interest and Setting Civil Money Penalties* (filed October 31, 2002) ("Plaintiff's Reply"); *Quinn and Tuckers' Sur-Reply and Memorandum in Support* (filed December 2, 2002)("Defendants' Sur-Reply"); *Response to Surreply [sic] of Richard A. Quinn and Scott W. Tucker* (filed December 9, 2002) ("Plaintiff's Response to Sur-Reply"); and *Quinn and Tuckers' Reply (Sur-Reply)* (filed December 19, 2002) ("Defendants' Sur-Sur-Reply").

2. *Partial Summary Judgment as to Richard A. Quinn and Scott W. Tucker* (entered June 5, 2002) (the "Opinion").

3. *See Opinion* at 7 (*Conclusions of Law* ¶¶ 4-5).

future violations of 15 U.S.C. § 77q(a), 15 U.S.C. § 78j(b), 15 U.S.C. § 78o(a)(1), and 17 C.F.R. § 240.10b-5.[4] In addition, Quinn and Tucker were each ordered to make disgorgement to the court-appointed agent, Leland C. de la Garza, in the amount of $7.5 million "together with prejudgment interest and post-judgment interest at the statutory rate provided for in 28 U.S.C. § 1961."[5] The Court also stated that, "[o]n proper motion," the SEC "may seek an award of civil monetary penalties."[6]

Subsequently, after their motion for reconsideration was denied, Quinn and Tucker appealed the Court's grant of partial summary judgment to the Fifth Circuit Court of Appeals (where the appeal is currently pending).[7]

II. ANALYSIS

Given that the Opinion granting partial summary judgment against Quinn and Tucker is currently pending on appeal, this Court will not revisit any issue which was decided therein—such issues are no longer properly before this Court. Leaving those issues aside, the remaining issues to be addressed are: 1) prejudgment interest, 2) civil penalty, and

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4. *Id.* at 7-9.

5. *Id.* at 9-10.

6. *Id.* at 10.

7. *See Order* (entered July 25, 2002) and *Notice of Appeal* (filed July 25, 2002).

3) administrative closure of this case. Each will be considered in turn.

A. Prejudgment Interest

The Opinion of June 5, 2002 ordered Quinn and Tucker to each make disgorgement in the amount of $7.5 million *"together with prejudgment interest* and post-judgment interest at the statutory rate provided for in 28 U.S.C. § 1961."[8] Thus, there is no question as to whether prejudgment interest will be due, rather the Court now need only determine the appropriate interest rate and start date so that the calculation can be made. As stated by the Second Circuit, "[t]he decision whether to grant prejudgment interest and the rate used if such interest is granted are matters confided to the district court's broad discretion." *S.E.C. v. First Jersey Securities, Inc.*, 101 F.3d 1450, 1476 (2d Cir.1996) (citing *Endico Potatoes, Inc. v. CIT Group/ Factoring, Inc.*, 67 F.3d 1063, 1071-72 (2d Cir. 1995)). Similarly, the Fifth Circuit has stated that "whether prejudgment interest should be awarded" in a Rule 10b-5 action "is a question of fairness resting within the District Court's sound discretion." *Wolf v. Frank, et al.*, 477 F.2d 467, 497 (5th Cir. 1973); *see also Riseman v. Orion Research, Inc., et al.*, 749 F.2d 915, 921 (1st Cir. 1984).

The SEC argues that prejudgment interest should be assessed at the IRS underpayment rate as set out in the regulations governing SEC administrative proceedings. *See* 17 C.F.R. § 201.600(b) (2002)(prejudgment interest

8. *Id.* at 9-10 (emphasis added).

"shall be computed at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), and shall be compounded quarterly.") The IRS underpayment rate is defined as the Federal short-term treasury-bill rate plus 3 percentage points, rounded to the nearest percent. 26 U.S.C. § 6621(a)-(b). Defendants respond by arguing that the Court "should set the amount at zero based on all the facts and circumstances of this matter."[9] Given that this Court has found Quinn and Tucker to have violated several provisions of federal securities laws and ordered disgorgement of $15 million, the Court will not provide Defendants with an interest free loan. Alternatively, Defendants argue that a lower rate of interest should be applied because use of the IRS underpayment rate "fails to make allowances for the value of cash and property already paid over to the Special Master" and does not take into account Quinn and Tucker's "demonstrated penury."[10] Defendants also claim that any delay in entering the final judgment is the fault of the SEC.

Defendants have not provided factual support for the assertions of current penury or SEC delay, and thus this Court finds those arguments unpersuasive. However, fairness concerns do necessitate that this Court take into account the timing of the appointment of the receiver for UEP. Pursuant to an agreement between the SEC, Quinn and Tucker, the receiver was appointed on June 10, 1999. Since that date, Quinn and Tucker have no longer have had access to or

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9. *Defendants' Sur-Reply* at 3.

10. *Defendants' Response* at 4.

control of the funds of UEP.[11] Therefore, in the interests of fairness, the Court chooses to depart from the otherwise generally appropriate benchmark of the IRS underpayment rate for the period after June 10, 1999. *See SEC v. First Jersey Securities, Inc.*, 101 F.3d at 1476-77. The IRS underpayment rate, as specified in 17 C.F.R. § 201.600(b), shall be applied for the period from January 30, 1998 to June 10, 1999.[12] *See* I.R.S. Rev. Rul.2002- 70, 2002 WL 31685552, *3-4 (table of underpayment rates). During the period from June 10, 1999 to the date Judgment is entered, interest will be applied pursuant to 17 C.F.R. § 201.600(b) except that the interest rate shall be *one-half* of the IRS underpayment rate.

The parties are hereby **ORDERED** to submit to this Court an agreed table calculating prejudgment interest, according to the terms herein specified, no later than 10 calendar days from the date of this Memorandum Opinion and Order.

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11. *See Agreed Order Appointing Special Master* (entered June 9, 1999). Defendants might argue that the date of the agreed temporary restraining order merits the same analysis. However, the temporary restraining order was, by definition, a temporary measure enacted pending the resolution of the case on its merits. As such, the Court finds that the date on which the receiver was appointed to be a more appropriate date.

12. The Court notes that the SEC only seeks interest from January 30, 1998, the date the Complaint was filed, "in part because it is unable to state with precision the dates on which Quinn and Tucker received each payment from an investor or the dates on which they made payments to investors." *Plaintiff's Motion* at 2 fn.2. Defendants have not addressed the issue of the appropriate start date.

Appendix B

B. Civil Penalties

Both the Securities Act of 1933 (the "Securities Act") and the Exchange Act of 1934 (the "Exchange Act") provide the SEC with broad authority to seek civil penalties. 15 U.S.C. §§ 77t(d), 78u(d)(3). This Court's Opinion of June 5, 2002 did not find that the SEC was entitled to a civil penalty; it simply allowed the SEC to "reserve the issue" for a subsequent motion—which has now been made.[13] The SEC seeks a third tier penalty of $110,000 for each of Quinn and Tucker. Conversely, Defendants argue that this case does not qualify for a third tier penalty, or indeed for any penalty at all.[14]

Section 20 of the Securities Act and § 21 of the Exchange Act allow a third tier penalty of up to $110,000 for each violation of the Securities (or Exchange) Act if two conditions are met: 1) "the violation . . . involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and 2) "such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons." 15 U.S.C. §§ 77t(d)(2)(C), 78u(d)(3)(B)(iii); 17 C.F.R. § 200.1001 (raising the maximum penalty per violation to $110,000). In this case, both of these requirements have been met. In finding that each of Quinn and Tucker "has

13. *Opinion* at 7, 10.

14. *Defendants' Response* at 5-8. Defendants cite *R & W Technical Services Ltd., v. Commodity Futures Trading Commission,* 205 F.3d 165 (5th Cir. 2000), however, *R & W* is inapposite as it is a case brought by the CFTC under the Commodity and Exchange Act.

violated and unless enjoined is likely to continue to violate 15 U.S.C. § 77q(a)(1)-(3), 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5," this Court addressed the legal predicate for the first requirement.[15] Section 17(a) of the Securities Act makes it unlawful, in the offer or sale of securities, to:

> (1) employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a)(1)-(3). Similarly, Rule 10b-5 makes it unlawful, in the purchase or sale of securities, to:

> (1) employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

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15. *Opinion* at 7 (*Conclusions of Law* ¶¶ 4-5).

> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

17 C.F.R. § 240.10b-5. This Court has held Quinn and Tucker each have violated both provisions. Therefore, Quinn and Tucker each satisfied the first part of the standard, *to wit,* they have been previously found by this Court to be *"involved in"* "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." In addition, the Court's factual findings establish that "a significant risk of substantial losses to other persons" was created by the conduct of Quinn and Tucker as owners of UEP. Quinn and Tucker, by failing to disclose that the investors were not treated equally, by not recording the assignment of investors' interest in particular wells, and by not disclosing that Quinn and Tucker would be granted overriding royalty interests at no cost, created "a significant risk of substantial losses" to their investors.[16]

As both statutory requirements have been met, Quinn and Tucker are each hereby ORDERED to pay a civil penalty of $110,000.

C. Administrative Closure

The SEC has stated that it does not plan to seek action against the third Defendant, UEP as the court-appointed receiver is "in the process of winding down the affairs of [UEP]. That will leave [UEP] essentially defunct."[17]

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16. *Opinion* at 3-4 (*Findings of Fact* ¶¶ 22, 25, 29-31).

17. *Plaintiff's Motion* at 5.

Therefore, administrative closure of this case will be proper after judgment is issued.

III. Conclusion

For the foregoing reasons, Plaintiff's motion is **GRANTED** as modified herein. The parties are hereby **ORDERED** to submit to this Court an agreed table calculating prejudgment interest, according to the terms herein specified, no later than 10 calendar days from the date of this Memorandum Opinion and Order.

It is so ORDERED.

Signed: January 28, 2003.

s/ Jerry Buchmeyer
JUDGE JERRY BUCHMEYER
UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS

APPENDIX C — PARTIAL SUMMARY JUDGMENT AS TO RICHARD A. QUINN AND SCOTT W. TUCKER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION DATED JUNE 3, 2002 AND FILED JUNE 4, 2002

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

Civil Action No.
3 :98-CV-0218-R

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

UNITED ENERGY PARTNERS, INC.,
a Texas corporation;
RICHARD A. QUINN; and
SCOTT W. TUCKER,

Defendants.

PARTIAL SUMMARY JUDGMENT AS TO RICHARD A. QUINN AND SCOTT W. TUCKER

This matter came before the Court on Plaintiff Securities and Exchange Commission's Motion for Partial Summary Judgment as to Defendants Richard A. Quinn and Scott W.

Appendix C

Tucker. Based on all the files, records and proceedings herein, the Court makes the following facts are undisputed:

Facts

1. Defendant United Energy Partners, Inc. ("United Energy") was incorporated in Texas in 1994 and was headquartered in Dallas, Texas.

2. United Energy was in the business of drilling oil and gas wells, and it continued to operate certain wells it drilled until the Court appointed a special master to do so.

3. Defendant Richard A. Quinn ("Quinn"), age 29 and a resident of Dallas at the time the action was commenced, was a director, the chief executive officer, the president and a 90 percent shareholder of United Energy.

4. Quinn received Series 22 and 63 securities licenses in 1991 while he had been associated with Kinlaw Securities Corporation ("Kinlaw"), but he has not been associated with a broker-dealer since he left Kinlaw in 1992.

5. Quinn was responsible for the activities of United Energy, and he directly offered and sold to investors undivided working interests in United Energy oil and gas wells and assisted other salespersons in doing so.

6. Defendant Scott W. Tucker ("Tucker"), age 35 and a resident of Dallas at the time the action was commenced, was the executive vice-president and a 10 percent shareholder of United Energy.

Appendix C

7. Tucker was responsible for training and supervising United Energy's sales staff.

8. Tucker directly offered and sold undivided working interests in United Energy wells.

9. Tucker was compensated with a 15 percent commission, a bonus and overrides.

10. While associated with United Energy, Tucker was not registered as or associated with a broker-dealer.

11. From June 1995 through January 1998, United Energy raised approximately $7.5 million from at least 285 investors located in at least 40 states through the offer and sale of securities in the form of undivided working interests in oil and gas wells.

12. United Energy formed 11 joint ventures, each of which offered working interests in one or more planned wells and pooled investor funds to drill drilled 16 wells.

13. United Energy employed between five and ten full-time salespersons who used lead lists to "cold call" potential investors nationwide.

14. United Energy salespersons initially solicited investors with "cold calls," then sent interested persons a copy of the joint venture's offering memorandum.

15. United Energy's salespersons, including Quinn and Tucker, followed up with potential investors to discuss the representations in the offering memoranda.

Appendix C

16. Quinn prepared, or directed the preparation of, the offering memoranda for United Energy's joint ventures.

17. Tucker trained United Energy sales representatives and oversaw telephone sales presentations made by them.

18. United Energy, Quinn and Tucker failed to disclose that commissions of 10 to 15 percent were paid to salespersons, including Tucker, from investment funds.

19. United Energy, Quinn and Tucker failed to disclose that, in one offering, Quinn caused Tucker to be paid one percent of all investment funds procured by other salespersons.

20. United Energy, Quinn and Tucker failed to disclose that United Energy paid a bonus to salespersons who secured investments from new investors.

21. Although the offering memoranda disclosed that a certain percent of the production revenue from the wells was to be granted in the form of overriding royalty interests, United Energy, Quinn and Tucker failed to disclose that United Energy would grant overriding royalty interests in several of the wells to Quinn and Tucker at no cost.

22. Although the offering memoranda represented that United Energy received no carried interest in any of the wells, but reserved the right to purchase an interest in the wells for its own account on the same terms as other participants, United Energy never purchased any interest in a well or paid any proportionate share of drilling expenses, but Quinn and Tucker did retain unsold interests at the time offerings closed.

Appendix C

23. Quinn and Tucker kept from five to 25 percent of the offerings for themselves.

24. The offering memoranda stated that all units in each joint venture were to be sold at a specified price.

25. United Energy, Quinn and Tucker failed to disclose that investors were not treated equally and that some potential investors were offered preferential treatment in certain of the joint ventures.

26. Some disappointed investors in wells with no production were offered the opportunity in a later joint venture to receive a quarter investment unit free with every unit purchased.

27. Other investors were given overriding royalty interests in certain ventures.

28. Quinn authorized those arrangements described in Paragraphs 24 through 26, and Tucker was aware of them.

29. None of these "special arrangements" was disclosed to the other participants in the joint ventures.

30. The offering memoranda represented that assignments of the investors' interest in the various wells were to be recorded in the appropriate county within 30 days after the well(s) went into production.

31. Even after investors insisted that assignments be recorded, Quinn refused to do so.

Appendix C

32. By the time the Commission commenced this action, no assignments had been recorded despite the fact that certain of the wells had been in production for months.

33. The offering memoranda represented that the total amount raised from investors in the offerings would be spent for drilling, testing, completing and equipping the wells.

34. The offering memoranda did state that United Energy would be responsible for all drilling cost overruns and would retain any excess funds from drilling cost savings.

35. In determining the amount of money to be raised from investors for a joint venture, Quinn's practice was to estimate the cost of drilling the well(s), add 15 percent for contingencies and then double that amount.

36. Investors were not told that Quinn would spend the excess monies raised at his discretion for non-well purposes.

37. Investors were not told that Quinn had padded United Energy's anticipated drilling costs by more than 100 percent

38. Upon receiving investment funds, United Energy earmarked half for drilling expenses and half for other uses.

39. Quinn used excess monies to pay sales commissions equaling 10 to 15 percent of the investment, to pay operating expenses for United Energy and to purchase lead lists from marketing companies.

Appendix C

40. Quinn spent funds to lease a Cadillac for himself and a Lexus for his girlfriend from investor funds.

41. Quinn paid for two out-of-state vacation trips for himself, Tucker and others from investor funds.

42. Quinn used investor funds to pay his rent, utility bills and credit card bills.

43. In 1996 United Energy spent more than $81,000 for Quinn's personal benefit.

44. United Energy, Quinn and Tucker did not disclose plans to expend monies for the purposes described in Paragraphs 38 through 42 to potential investors.

45. The offering memoranda misrepresented the projected return on investment and oil and gas production.

46. The projections in the offering memoranda were exaggerated and lacked a reasonable basis.

47. At times, Quinn pressured United Energy's geologist to inflate his production projections without any reasonable basis for doing so.

48. Well production never met the minimum projections set out in the offering memoranda, and no investor received a return equal to his original investment.

49. Both Quinn and Tucker were aware that the stated costs of drilling, testing and completing the wells were double the actual anticipated costs.

Appendix C

50. Both Quinn and Tucker told United Energy sales representatives that Quinn was purchasing working interests in the wells, and the representatives passed that information on to potential investors even though no one at United Energy invested in any of the joint ventures.

51. United Energy also sent copies of the offering memoranda by mail and/or by air courier service.

52. United Energy, Quinn and Tucker ceased their sales activities only after being served with Commission subpoenae.

53. Quinn expressed an intention to return to the business of offering and selling undivided interests in oil and gas wells.

54. In addition to the overrides and United Energy's payment of his personal expenses, Quinn received $445,328 from his employment with United Energy.

55. In addition to the overrides and United Energy's payment of his personal trip expenses, Tucker received $270,508 from his employment with United Energy.

Based on the foregoing undisputed facts, the Court reaches the following:

Conclusions Of Law

1. The Court has subject matter jurisdiction.

2. The Court has personal jurisdiction over Quinn and Tucker.

3. The investments offered and sold by United Energy, Quinn and Tucker are fractional undivided interests in oil and gas rights and investment contracts and are therefore "securities."

4. Quinn has violated and unless enjoined is likely to continue to violate 15 U.S.C. §77q(a)(l)-(3), 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5.

5. Tucker has violated and unless enjoined is likely to continue to violate 15 U.S.C. §77q(a)(1)-(3), 15 U.S.C. §78j(b), 17 C.F.R. §240.10b-5 and 15 U.S.C. §780(a)(1).

6. Quinn and Tucker are liable for the violations of United Energy.

7. The Commission is entitled to an injunction against Quinn and Tucker.

8. The Commission is entitled to disgorgement from Quinn and Tucker.

9. Quinn and Tucker are jointly and severally liable for the disgorgement due from themselves and from United Energy.

10. The Commission is entitled to reserve the issue of civil monetary penalties.

Based on the foregoing undisputed facts and Conclusions of Law,

IT IS ORDERED:

Appendix C

A. Quinn and Tucker, individually and jointly, and their agents, employees, servants, attorneys and all persons in active concert or participation with them who receive actual notice of this Partial Summary Judgment, by personal service or otherwise, be and hereby are enjoined and restrained from any of the following:

1. violating section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), by, directly or indirectly, in any way in connection with the offer or sale of any security by the use of any means or instrument of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly --

(a) employing any device, scheme or artifice to defraud, or

(b) obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statement(s) made, in the light of the circumstances under which were made, not misleading, or

(c) engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser, including, but not limited to, the offer and/or sale of an investment in a "prime bank" trading program and/ or the unfounded promise or representation that repayment of monies previously invested in a "prime bank" trading program is likely to be made;

2. (a) violating section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), by, directly or indirectly, by the use of any means or instrumentality of interstate commerce, of the mails or of any facility of any national securities exchange, using or employing in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered any manipulative or deceptive device or contrivance in contravention or a rule or regulation prescribed by the Securities and Exchange Commission and/or

(b) violating Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. §240.10b-5, by, directly or indirectly, by the use of any means or instrumentality of interstate commerce, of the mails or of any facility of any national securities exchange,

(1) employing any device, scheme or artifice to defraud,

(2) making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statement(s) made, in the light of the circumstances under which were made, not misleading, or

(3) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, including, but not limited to, the offer and/or sale of an investment in a "prime bank" trading program

and/or the unfounded promise or representation that repayment of monies previously invested in a "prime bank" trading program is likely to be made; and

B. Tucker and his agents, employees, servants, attorneys and all persons in active concert or participation with him who receive actual notice of this Partial Summary Judgment, by personal service or otherwise, be and hereby are restrained and enjoined from, directly or indirectly, violating section 15(a)(1) of the Securities Exchange Act, 15 U.S.C. §78o(a)(1), by making use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptance or commercial bill) unless he is associated with a broker or dealer that is registered in accordance with section 15(b) of the Securities Exchange Act, 15 U.S.C. §78o(b).

C. Quinn and Tucker shall make disgorgement to Leland C. de la Garza, as court-appointed agent, the following amounts:

Payor	Amount
Quinn	$7.5 million
Tucker	$7.5 million

together with prejudgment interest and post judgment interest at the statutory rate provided for in 28 U.S.C. §1961.

Appendix C

D. On proper motion, the Commission, the Commission may seek an award of civil monetary penalties.

E. Based on the Court's express determination that there is no just reason for delay, the Clerk shall enter judgment accordingly.

Dated: 3 June 02

s/ Jerry L. Buchmeyer
Jerry L. Buchmeyer
United States District Judge

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT DENYING PETITION FOR REHEARING FILED MAY 3, 2004

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 02-10850
consolidated with No. 03-10322

SECURITIES AND EXCHANGE COMMISSION

Plaintiff - Appellee

v.

UNITED ENERGY PARTNERS, INC; ET AL

Defendants

RICHARD A. QUINN; SCOTT W. TUCKER

Defendants - Appellants

Appeal from the United States District Court for the Northern District of Texas, Dallas

ON PETITION FOR REHEARING

Before SMITH, BARKSDALE, and CLEMENT, Circuit

Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing is DENIED.

ENTERED FOR THE COURT:

s/ RCH Barksdale
United States Circuit Judge

(3)

Supreme Court, U.S.
FILED
NOV 8 - 2004
OFFICE OF THE CLERK

No. 04-173

In the Supreme Court of the United States

RICHARD A. QUINN, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

PAUL D. CLEMENT
Acting Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

GIOVANNI P. PREZIOSO
General Counsel

MEYER EISENBERG
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

LESLIE E. SMITH
Senior Litigation Counsel
Securities and Exchange Commission
Washington, D.C. 20549

QUESTION PRESENTED

Whether the district court abused its discretion in calculating the amount of disgorgement in a civil enforcement action brought by the Securities and Exchange Commission.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	4
Conclusion	7

TABLE OF AUTHORITIES

Cases:

Graham v. *SEC*, 222 F.3d 994 (D.C. Cir. 2000)	6
SEC v. *Bilzerian*, 29 F.3d 689 (D.C. Cir. 1994)	4
SEC v. *Blatt*, 583 F.2d 1325 (5th Cir. 1978)	4
SEC v. *First Jersey Secs.*, 101 F.3d 1450 (2d Cir. 1996), cert. denied, 522 U.S. 812 (1997)	6
SEC v. *First Pac. Bancorp.*, 142 F.3d 1186 (9th Cir. 1998), cert. denied, 525 U.S. 1121 (1999)	5
SEC v. *Patel*, 61 F.3d 137 (2d Cir. 1995)	4
SEC v. *Thomas James Assocs.*, 738 F. Supp. 88 (W.D.N.Y. 1990)	5
Wickham Contracting Co. v. *Local Union No. 3*, 955 F.2d 831 (2d Cir.), cert. denied, 506 U.S. 946 (1992)	6

Statutes, regulation and rule:

Securities Act of 1933, § 17(a), 15 U.S.C. 77q(a)	3
Securities Exchange Act of 1934, § 10(b), 15 U.S.C. 78j(b)	3
17 C.F.R. 240.10b-5	3
Sup. Ct. R. 14.1(a)	5

In the Supreme Court of the United States

No. 04-173

RICHARD A. QUINN, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is not published in the *Federal Reporter* but is available at 88 Fed. Appx. 744. The January 28, 2003 opinion of the district court (Pet. App. 8a-17a) is not published in the *Federal Supplement* but is available at 2003 WL 223392. The June 3, 2002 order of the district court (Pet. App. 18a-30a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 18, 2004. A petition for rehearing was denied on May 3, 2004 (Pet. App. 31a-32a). The petition for a writ of certiorari was filed on August 2, 2004 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. United Energy Partners (United Energy) was a Texas corporation engaged in the business of drilling oil and gas wells. Petitioner Richard A. Quinn was the president and chief executive officer of United Energy and a 90% shareholder. Petitioner Scott W. Tucker was the executive vice president and owned the other 10% of the company's stock. United Energy formed joint ventures that offered undivided working interests in oil and gas wells. Between June 1995 and January 1998, petitioners raised approximately $7.5 million from at least 285 investors through the sale of those interests. Pet. App. 19a-20a.

The offering memoranda for the joint ventures represented that the total amount raised from investors would be spent on drilling, testing, completing, and equipping the wells. In fact, however, only half of the funds received from investors was earmarked for drilling expenses. The other half was used to pay sales commissions, to cover United Energy's operating expenses, and to purchase "lead lists" from marketing companies. Investor funds were also used to pay Quinn's rent, utility bills, and credit-card bills; to lease a Cadillac for Quinn and a Lexus for his girlfriend; and to pay for vacations for Quinn, Tucker, and others. Pet. App. 23a-24a.

2. In January 1998, the Securities and Exchange Commission (Commission) brought a civil law-enforcement action against Quinn, Tucker, and United Energy, alleging violations of the anti-fraud provisions of the securities laws. After appointing a special master to operate United Energy (Pet. App. 3a, 12a-13a), the district court entered partial summary judgment for the Commission on its claims against Quinn and Tucker

(*id.* at 18a-30a). On the basis of undisputed facts (*id.* at 19a-25a, 26a), the district court found (*id.* at 26a) that Quinn and Tucker made misrepresentations in connection with the sale of securities and thereby violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. The court enjoined Quinn and Tucker from further violations of the anti-fraud provisions of the securities laws and ordered them, jointly and severally, to disgorge $7.5 million, together with pre-judgment interest. Pet. App. 26a-30a. In a subsequent order, the district court determined the pre-judgment interest rate and imposed a civil penalty on Quinn and Tucker of $110,000 each. *Id.* at 8a-17a.

3. In an unpublished per curiam opinion, the court of appeals affirmed. Pet. App. 1a-7a. The court held that the district court did not err in entering summary judgment (*id.* at 3a-4a) and did not abuse its discretion in granting injunctive relief (*id.* at 4a), ordering disgorgement (*id.* at 4a-5a), ordering the payment of pre-judgment interest (*id.* at 6a), or imposing a civil penalty (*id.* at 6a-7a). With respect to disgorgement, the court of appeals held that "[t]he $7.5 million raised is a reasonable estimate of the profits received by fraud." *Id.* at 5a. It rejected petitioners' contentions that the disgorgement order should have been based "on the much smaller amount they received through their employment with United Energy" and that the district court should have "offset against the disgorgement order the amounts spent on legitimate business expenses." *Id.* at 4a.

ARGUMENT

1. Petitioners contend (Pet. 4-10) that the district court abused its discretion in calculating the amount of disgorgement. The court of appeals correctly held otherwise, and its decision does not conflict with any decision of this Court or any other court of appeals. Further review is therefore unwarranted.

Petitioners contend that the district court miscalculated the amount of disgorgement because the $7.5 million they were ordered to pay "represents the entirety of the *proceeds* obtained by United Energy, not the *profits* [p]etitioners received from their involvement with United Energy." Pet. 4. Petitioners argue that their "profits" were limited to the approximately $800,000 they assertedly received "from their employment with United Energy." *Ibid.* In the alternative, they argue that the $7.5 million should have been offset by the approximately $3.75 million that was assertedly "devoted to drilling expenses" (Pet. 8) and thus constitutes "legitimate business expenses" (Pet. 7).

Petitioners are mistaken. As the very cases they cite (Pet. 5) recognize, the meaning of "profits," in the context of a fraudulent sale of securities, is the difference between the amount received from the investors and the true value of the securities provided in return. See *SEC* v. *Patel*, 61 F.3d 137, 139-140 (2d Cir. 1995); *SEC* v. *Bilzerian*, 29 F.3d 689, 696-697 (D.C. Cir. 1994); *SEC* v. *Blatt*, 583 F.2d 1325, 1327-1328, 1335 n.30 (5th Cir. 1978). Because petitioners offered no evidence of the value of the securities they sold (see SEC C.A. Br. 23), the district court permissibly found that the profits for which they were jointly and severally liable were equivalent to the proceeds, and the court of appeals correctly held that "[t]he $7.5 million raised is a

reasonable estimate of the profits received by fraud" (Pet. App. 5a). Contrary to petitioners' contention (Pet. 5-6), the court of appeals' decision does not conflict with decisions recognizing courts' authority to order disgorgement of profits, because that is the principle the court of appeals applied.

Nor is there a circuit conflict on the question whether the amount of disgorgement must be offset by "legitimate business expenses." Pet. 7. The only decisions cited by petitioners that address that issue (Pet. 7-8) are decisions of district courts. The cases on which petitioners rely, moreover, hold only that the amount of disgorgement *may* be offset by business expenses, not that it must be. See, *e.g.*, *SEC* v. *Thomas James Assocs.*, 738 F. Supp. 88, 95 (W.D.N.Y. 1990).*

2. Petitioners also contend (Pet. 10-11) that the district court abused its discretion in ordering them to pay pre-judgment interest. The question presented in the certiorari petition (Pet. i) concerns disgorgement, however, and the question whether pre-judgment interest was permissibly awarded is not "fairly included therein." Sup. Ct. R. 14.1(a). In any event, petitioner's challenge to the award of pre-judgment interest is without merit and does not warrant review by this Court.

Petitioners first argue that the purpose of awarding pre-judgment interest is to prevent a defendant from

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* Petitioners do not challenge in this Court the principle of joint and several liability applied by the district court in requiring them to disgorge the total amount of funds raised by the three violators (Quinn, Tucker, and United Energy). As the court of appeals recognized (Pet. App. 5a), that principle is firmly established in Commission enforcement actions. See, *e.g.*, *SEC* v. *First Pac. Bancorp*, 142 F.3d 1186, 1191-1192 (9th Cir. 1998) (citing cases), cert. denied, 525 U.S. 1121 (1999).

having the benefit of an interest-free loan in the amount of his ill-gotten gains, and that, because they "gave up everything of value they owned to the Special Master," they did not receive an interest-free loan. Pet. 10. That is incorrect. The funds of which the special master took control did not include the entire amount of petitioners' ill-gotten gains. Moreover, petitioners were ordered to pay the full amount of pre-judgment interest only for the period before the special master was appointed. See Pet. App. 11a-13a. For the period after the appointment, the district court cut the interest rate in half. *Ibid.*

Petitioners also argue that a district court may not award pre-judgment interest before considering "the need to fully compensate the wronged party for actual damages suffered," and that, because the Commission is not a victim, there is no need to "fully compensate the Commission." Pet. 10-11 (quoting *SEC* v. *First Jersey Secs.*, 101 F.3d 1450, 1476 (2d Cir. 1996), cert. denied, 522 U.S. 812 (1997)). That theory is equally misconceived. The need for compensation is one of four factors that were originally set forth in a case involving private parties. See *Wickham Contracting Co.* v. *Local Union No. 3*, 955 F.2d 831, 833-834 (2d Cir.), cert. denied, 506 U.S. 946 (1992). Since injury and damages need not be proved in a civil enforcement action brought by the Commission, see, *e.g.*, *Graham* v. *SEC*, 222 F.3d 994, 1001 n.15 (D.C. Cir. 2000), the factor has no relevance here.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

PAUL D. CLEMENT
Acting Solicitor General

GIOVANNI P. PREZIOSO
General Counsel

MEYER EISENBERG
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

LESLIE E. SMITH
Senior Litigation Counsel
Securities and Exchange Commission

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IN THE

Supreme Court of the United States

RICHARD A. QUINN and SCOTT W. TUCKER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

REPLY BRIEF

HILAREE A. CASADA
Counsel of Record
JULIA F. PENDERY
GODWIN GRUBER, LLP
Renaissance Tower
1201 Elm Street
Suite 1700
Dallas, TX 75270-2084
(214) 939-4400

Attorneys for Petitioners

191130

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

ARGUMENTS IN REPLY TO THE BRIEF FOR THE RESPONDENT IN OPPOSITION

I. The Respondent's interpretation of "profits" is misplaced and ignores Fifth Circuit precedent that disgorgement is not punitive in nature.

The district court ordered the Petitioners to disgorge $7.5 million, which was the total amount the Commission contended United Energy had raised from investors between June 1995 and January 1998. This amount represents the entirety of the *proceeds* obtained by United Energy, not the *profits* Petitioners received from their involvement with United Energy. As such, the entire disgorgement award amounts to an improper penalty.

A. A party is only required to disgorge its profits, not all of the proceeds, resulting from the fraudulent activity.

The law is settled that a party is only required to disgorge its *profits* resulting from a fraud. *See Commodity Futures Trading Comm'n v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999) (noting that a district court may not disgorge profits obtained without the aid of any wrongdoing)[1]; *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (stating that "disgorgement need only be a reasonable approximation of the profits causally connected to the violation"); *SEC v. Bilzerian*, 29 F.3d 689, 697 (D.C. Cir. 1994) (upholding the district court's order reasonably approximating illicit profits); *Commodity Futures Trading Comm'n v. Am. Metals Exch. Corp.*, 991 F.2d 71, 77 n.10

1. Cases involving the Commodity Exchange Act have followed the rationale supporting disgorgement in actions under the securities laws—that allowing a violator to retain the profits from his violation would frustrate the purposes of the regulatory scheme. *Id.* at n.9. Thus, the law applied in cases involving the Commodity Futures Trading Commission also applies to cases where the Securities Exchange Commission is a party.

(3d Cir. 1993) (holding that a trial court abused its discretion by not holding a hearing to determine the amount of illegal profits); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (holding that the district court had the equitable power to order a party to disgorge only those amounts with interest by which the party profited from his wrongdoing).

The term "profit" is not defined by the Securities Exchange Act. "Profit" must, therefore, be assumed to have its ordinary or usual meaning: the excess of revenues over expenditures in a business transaction. *Heli-Coil Corp. v. Webster*, 352 F.2d 156, 168 (3d Cir. 1965); BLACK'S LAW DICTIONARY 1226 (7th ed. 1999). Here, that would include only the profits Quinn and Tucker received from their involvement with United Energy, not the entire proceeds of $7.5 million. The summary judgment evidence showed, and the district court found, that Petitioners' realized no more than $796,000 in profits. (Pet. App. 24a-25a, Findings 43, 54, and 55). Those profits included money spent for Petitioners' personal expenses, payment of overrides, and money received from Petitioners' employment with United Energy. (*Id.*). The district court's decision to order disgorgement of all proceeds raised is, thus, contrary to its own findings that Petitioners received only $796,000 in profits. Similarly, that decision disregarded summary judgment evidence that some programs turned a profit for investors, while others returned the contributions of several investors to those investors. This evidence further shows that the $7.5 million did not reflect Petitioners' profits. Rather, some of those proceeds were ultimately returned to investors as profits.

This decision also contradicts decisions from the majority of Circuit courts, including the Fifth Circuit, that have addressed the calculation of disgorgement amounts. For example, in *Blatt*, John Pullman purchased certain shares of stock for $59,662. *Blatt*, 583 F.2d at 1327. Six months later, Pullman sold the stock for $375,000, giving Pullman a profit of approximately $315,000. *Id.* at 1328. The district court ordered Pullman

to disgorge only the $315,000 in actual profits. *Id.* at 1335. The Fifth Circuit affirmed, holding that the disgorgement amount properly represented the amount of the defendant's ill-gotten gain. *Id.* Had the district court and Fifth Circuit followed *Blatt* in this case, the disgorgement amount could not have exceeded $796,000. A writ of certiorari is necessary to correct the conflict created by the erroneous decision to order disgorgement of the entire $7.5 million in investment funds.

B. The district court's failure to offset the disgorgement amount with legitimate business expenses resulted in a punitive award.

The Fifth Circuit also improperly refused to offset the disgorgement amount with legitimate business expenses. As noted *supra*, a disgorgement award should not exceed the profits actually gained by the wrongdoer. Here, the district court's disgorgement order far exceeds the profits realized by Petitioners and fails to take into account the monies used by United Energy for legitimate business expenses.

Although Respondent correctly states the general rule that disgorgement awards *may* be offset by legitimate business expenses in furtherance of the participants' investment objectives, reliance on the discretionary "may" language goes against Fifth Circuit precedent discussing the purpose of disgorgement. *See SEC v. Blatt*, 583 F.2d 1325 (5th Cir. 1978). In *Blatt*, the Fifth Circuit unequivocally stated that disgorgement is not punitive. *Blatt*, 583 F.2d at 1335. The court further held that a court's disgorgement power "extends only to the amount with interest by which the defendant profited from his wrongdoing." *Id.* Thus, a court must consider legitimate business expenses as an offset to a disgorgement award so as to ensure that a party is not being punished in excess of the amount from which he profited.

Although the case law relied upon consists of opinions from district courts, this should not hinder the Court's review of the issue. This situation is not an isolated one. On the contrary, the lower courts must frequently determine disgorgement awards. Unfortunately, the Fifth Circuit does not uniformly offset legitimate business expenses against disgorgement awards. Rather, the Fifth Circuit, as in this case, includes legitimate business expenses, which results in a windfall to the opposing party in the amount of damages awarded. By so doing, the Fifth Circuit has disregarded well-established precedent and thwarted the very purpose of disgorgement (i.e. to force a defendant to give up the amount by which he was unjustly enriched and not to unfairly penalize him). If this Court does not correct the Fifth Circuit's error, this injustice will frequently recur, placing future defendants at risk for punitive disgorgement awards. As such, granting the Petition on this issue is warranted and necessary to protect Quinn's and future defendants' due process rights. Moreover, the likelihood that this error will recur is so great that the Court should address this issue now, rather than allowing the issue to unnecessarily percolate further in the district courts. A writ of certiorari is, thus, necessary to ensure that neither Petitioners nor future litigants are forced to endure a punitive disgorgement award.

II. Petitioners have not waived their argument regarding prejudgment interest because the proper calculation of prejudgment interest is directly tied to the question presented regarding the proper calculation of disgorgement damages.

Supreme Court Rule 14.1(a) states in part "the statement of any question presented is deemed to compromise every subsidiary question fairly included therein." Sup. Ct. R. 14.1(a); *see also Yee v. City of Escondido*, 503 U.S. 519, 537 (1992). Since the district court's errors in determining a disgorgement amount make its award of prejudgment interest improper, Petitioner's prejudgment interest argument is a subsidiary

question of the disgorgement issue and did not need to be presented as a separate issue under Rule 14.1(a).

Further, Rule 14.1(a) serves two important and related purposes: to provide respondents with notice of the grounds upon which petitioner is seeking certiorari and to assist this Court in selecting cases to grant review. *Yee*, 503 U.S. at 537. By not presenting their prejudgment argument as a separate issue, Petitioners have not frustrated either of these stated purposes. Petitioners' briefing of this issue in their Petition gave Respondent fair notice that Petitioners have brought the issue of prejudgment interest to the Court. As such, the purposes of Supreme Court Rule 14.1(a) have been met, and Petitioners have not waived their argument. Petitioners respectfully pray that the Court address the issue of whether the Fifth Circuit improperly awarded prejudgment interest in conjunction with the issue regarding whether the disgorgement amount was proper.

CONCLUSION

Petitioners Richard A. Quinn and Scott W. Tucker, therefore, respectfully pray that the Court issue a writ of certiorari to review the Fifth Circuit opinion in this case.

Respectfully submitted,

HILAREE A. CASADA
Counsel of Record
JULIA F. PENDERY
GODWIN GRUBER, LLP
Renaissance Tower
1201 Elm Street
Suite 1700
Dallas, TX 75270-2084
(214) 939-4400

Attorneys for Petitioners